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SUBJECT: Taking Stock of Austria's Financial Markets
and Crisis Impacts

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previous

¶1. SUMMARY: The Austrian government was decisive in
crafting a EUR 100 billion financial sector rescue
package in October, but implementation has been slow.
Credit is scarce; demand is weak for GoA-guaranteed
interbank funding; only one major bank (Hypo Alpe
Adria) has gotten actual equity from the state so far;
and the GOA is pursuing a non-transparent policy on
funding other banks. On January 2, the Financial
Market Authority/FMA put a government commissioner in
charge of Bank Medici (which channeled money to Madoff
vehicles): with an exposure of over \$2 billion, Bank
Medici customers are among those hardest hit by the
Madoff scandal. Troubled Kommunalkredit bank was
nationalized January 5. The Vienna Stock Exchange was
among Europe's worst performers in 2008, with its main
index falling 60% and market capitalization down by
two-thirds.

¶2. On the bright side, the financial crisis has
bolstered Austrian opinions of the EU and the ECB, and
Austrian banks are not backing away from markets in
emerging Europe. END SUMMARY.

Banks: Show Us the (Public) Money
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¶3. Observers here universally praise the GoA for
passing the EUR 100 billion rescue package in October
-- comprising EUR 15 billion for equity injections
into banks/insurance companies and EUR 85 billion to
guarantee intrabank lending. However, implementation
has been mixed. In late December, leading economists
and Austrian National Bank (OeNB) Governor Ewald
Nowony urged banks to take the money and called on
the GoA to speed up implementation. Hannes Androsch
co-head of the new state bank holding company (IMBAG)
urged Finance Minister Josef Proell to speed up
payouts: Proell replied that the money is there for
the taking, as long as banks fulfill requirements.

¶4. Aside from specialty lender Kommunalkredit, so far
only Hypo Alpe Adria bank (HAA) has seen actual state
money: in late December 2008, it got EUR 900 million
in form of participation shares, at an 8% interest
rate and with conditions including limits on dividend
payments and a requirement that HAA must lend twice
the amount received (i.e. EUR 1.8 billion) to SMEs
over the next three years. HAA's ownership structure
remains unchanged, but the GoA can convert the
participation shares into ordinary shares at any time.
HAA has a call option to name a buyer at any time for
the GoA's participation shares. HAA also received

from its parent (the German Bayerische Landesbank) a EUR 700 million equity increase which with the GoA injection will push HAA's Tier 1 capital ratio to 8.4%. HAA, which had a troubled record even before 2008, was the Austrian bank in direst need.

15. Most or all of the top five Austrian banks are set to take state equity injections, but progress has been surprisingly slow. Volksbanken AG, with its exposure to failed Kommunalkredit bank, is likely to be the next to receive a GoA equity injection. In December, Volksbanken shareholders authorized management to take state capital of up to EUR 1 billion. Erste Bank's management is authorized to take in up to EUR 2.7 billion participation capital, Raiffeisen Zentralbank's (RZB) up to 2 billion. BAWAG (owned by U.S. private equity fund Cerberus Capital Management) reportedly had initial talks with the OeNB and the FMA for EUR 300-400 million in new equity, but has not started negotiations with the Finance Ministry. Bank Austria (owned by the Italian UniCredit group) has shown interest, but has not made a decision.

16. Credit is still scarce, even with GoA-guaranteed interbank lending auctions underway (a EUR 85 billion program). To date only few auctions have taken place and demand was light. As in Germany, Austrian banks can use the GoA guarantee for issuing bonds -- but few have done so.

17. Reasons for slow implementation include
-- Waiting for approval in Brussels (until mid-

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December), as the Commission sought to prevent competitive advantages in any member state
-- Apparently, a requirement (added by the EU) that taking state equity prior to December 31 would entail paying a full six months' interest
-- Efforts by the GOA Finance Ministry to add new conditions, such as requirements to lend to SMEs.
COMMENT: the new conditions are in part political cover against charges of "bailing out" rich bankers -- but also a legitimate attempt to make banks lend and prevent a downward credit spiral.

Kommunalkredit Bank Nationalized

18. In November, the GoA decided to nationalize the troubled Austrian banking group Kommunalkredit. The move was approved by the Federal Competition Authority and became effective January 5, 2009. The GoA took over (for a symbolic one Euro each) the shares of Volksbanken (50.78%) and the Belgian-French Dexia Credit Local (49.0%), while the Austrian Association of Municipalities, which holds 0.22%, remains a shareholder.

Bank Medici Investors Lost Billions in Madoff Scheme

19. The Austrian Bank Medici (75% owned by Sonja Kohn, 25% by Bank Austria) is among those hit hardest by the Madoff scandal. Bank Medici's Madoff exposure is about US\$ 2.1 billion, most of it reportedly from clients outside Austria (Russians, Ukrainians and Israelis) but apparently also prominent bankers such as former OeNB president Adolf Wala. Bank Medici is a small Austrian bank which marketed Madoff-linked investments through other banks and asset managers in Europe and beyond. In Austria, Bank Medici is not seen as "system-relevant;" until this month, most Austrians did not even know the bank's name (the minimum investment was EUR 50,000). The bank has only 16 employees and derived most of its earnings from

fees linked to Madoff products.

¶10. On January 2, when Bank Medici's two managing directors resigned, the FMA appointed an auditor as government commissioner to protect the interests of creditors and secure entrusted assets. (NOTE: Under the Austrian Banking Act (para 70/2), the FMA may order temporary measures (up to 18 months) or appoint a government supervisor to address threats to the financial interests of a bank's clients - END NOTE). High-profile media reports (including in the New York Times) say Bank Medici founder Sonja Kohn has dropped out of sight -- although journalists were apparently in touch with her as of January 14.

¶11. New York law firm Stull, Stull & Brody has petitioned to introduce a class action suit in New York court on behalf of investors in the funds Herald USA, Herald Luxemburg, Primeo Select and Thema International from January 2002 through January 12, 2008. The suit -- not yet filed -- alleges monies were invested in Madoff vehicles without the knowledge of investors. It will name as defendants Bank Medici along with Bank Austria, UniCredit, Pioneer Alternative Investments, Ernst and Young, and HSBC Holdings.

Austrian Banks To Stay in Emerging Europe

¶12. Austrian banks -- which have an asset exposure to markets in Central, Eastern, and Southeastern Europe (CESEE) and the former Soviet Union (FSU) almost as large as Austria's GDP -- say they are determined to remain in eastern markets and still see growth potential there. Banks feel they can manage the heightened risks with their solid base of deposits in the region and with GoA equity injections pushing most banks' consolidated equity ratios to 10 percent or above. COMMENT: Austrian banks see no alternative to staying in emerging Europe. Raiffeisen International says it learned from staying put in Russia during the 1998 ruble crisis -- recapitalizing at a cost of several hundred million dollars -- a key choice that made Raiffeisen the largest foreign bank in Russia and

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earned it tidy sums during the good years that followed.

A Crash Year for the Vienna Stock Exchange

¶13. 2008 was the worst year for the Vienna Stock Exchange since the Austrian Traded Index (ATX) debuted eighteen years ago. At year-end 2008, the ATX stood at 1,801 -- 60.1% lower than a year before (4,513) -- a worse fall than many other OECD stock exchanges: U.S. Dow Jones -34%, German DAX -40%, Japanese Nikkei -42%. Market capitalization of listed domestic shares was down 66% from year-end 2007 at only EUR 53 billion (about 19% of GDP). Vienna had no new domestic listings in 2008.

Austrians now have more faith in EU than in GOA or USG

¶14. While some Austrians lost trust in their banks despite the unlimited deposit guarantee -- the OeNB says currency demand spiked in October as individuals stashed money in safe deposit boxes (or their mattresses) -- the crisis has bolstered opinions of the European Union. A domestic poll taken in late November showed that Austrians have more confidence in the EU's crisis management than in their own government or in U.S. authorities:

Austrians' Opinions of
Ability to Respond to Economic Crisis

	MUCH	LITTLE	NONE
EU	44%	42%	11%
GOA	37%	42%	14%
USA	13%	36%	45%

This development is noteworthy since Austrians typically among the EU's main skeptics: in June, only 36% of Austrians said the country benefited from EU membership (EU average: 54%). In Eurobarometer polling in October/November, Austrians showed the biggest jump in support among member states: currently 47% say that EU membership brings benefits. A solid majority (57%) trust the European Central Bank, significantly above the ECB's EU-wide approval rating (48%).

GIRARD-DICARLO